



Betty T. Yee, Chairwoman State Board of Equalization

Serving the 8.5 million Californians of the First Equalization District,
comprised of 21 counties along the northern and central California coast,
including the entire San Francisco Bay Area.



VOLUME I, ISSUE 4 OCTOBER—DECEMBER 2007

To learn more about
services provided by
the State Board of
Equalization, please
call my office or
visit my website at:

www.boe.ca.gov/members/yee

**SAN FRANCISCO
DISTRICT OFFICE**
455 Golden Gate Avenue,
Suite 10500

San Francisco, CA 94102
Office: 415-557-3000
Fax: 415-557-0287

**SACRAMENTO
HEADQUARTERS
OFFICE**

450 N Street, MIC: 71
Sacramento, CA 95814
Office: 916-445-4081
Fax: 916-324-2087

Quarterly e-Newsletter

Happy New Year! Thank you for reading my e-newsletter for the fourth quarter of 2007.

What a difference a year makes! I will be handing over the gavel of my chairship of the State Board of Equalization (BOE) to one of my fellow Board Members at the end of January 2008. I would like to take the opportunity to thank my colleagues on the Board for a very productive 2007. I am fortunate to have chaired a most collegial Board. Although we have differences in opinions and perspectives among us, we have held respect and courtesy in the highest regard, allowing these differences to be aired and considered in our deliberations.

I also have enjoyed my membership on the Franchise Tax Board (FTB) this past year. The FTB continues to be a model of excellence in tax administration and is the envy of tax agencies throughout the nation, including that of the Internal Revenue Service (IRS). In my work, I have strived to ensure that customer service remains integral to the daily work of the BOE and FTB. In so doing, I am confident of the commitment of the staff in both agencies to be accessible, helpful, and fair when working with taxpayers.

I have taken the opportunity to highlight some major accomplishments in 2007 in this issue of my quarterly e-newsletter, as well as to discuss some challenges that lie ahead in 2008. Again, Happy New Year, and I wish you a very blessed 2008.

Sincerely,

BETTY T. YEE
Chairwoman

Significant Accomplishments in 2007

Under the leadership of Chairwoman Yee, the Board exercised its authority to make some significant policy decisions in 2007. These decisions include the following:

Increasing the tax rate on flavored malt beverages to the rate applicable to distilled spirits.

On August 14, 2007, Chairwoman Yee along with Board Vice Chair Judy Chu and State Controller John Chiang approved Regulations 2558, 2559, 2559.1, 2559.3, and 2559.5 to tax flavored malt beverages (FMBs), commonly known as “alcopops,” at the same rate that distilled spirits are taxed. Commonly marketed to women and teens, FMBs contain distilled alcohol and currently are taxed at the same rate as beer. Advocates for youth and other interests had petitioned the Board for such action, asserting the higher tax rate on these products will discourage under-age drinkers from consuming these products. The regulation is pending approval by the Office of Administrative Law.



Implementing fair property taxation for petroleum refinery property. On August 14, 2007, Chairwoman Yee along with Board Vice Chair Judy Chu and State Controller John Chiang re-adopted Property Tax Rule 474 relating to how real property, personal property, and fixtures used in refining petroleum should be valued. The Office of Administrative Law has disapproved the proposed rule because of deficiencies in the Initial Statement of Reasons submitted as part of the rulemaking file. However, upon re-adoption by the Board subsequent to correcting the Initial Statement of Reasons, the OAL approved the rule.

The practical effect of the rule is that for purposes of recognizing declines in property value, fixtures, machinery, and equipment classified as “improvements” will now be part of the same appraisal unit that contains structures and associated lands. This more truly reflects the integral nature of such improvements in petroleum refinery operations and will ensure fair property taxation of refinery properties.

Recognizing the emergence of the solar energy industry by clarifying the application of tax on solar construction contracts. On September 12, 2007, the Board unanimously approved revisions to Regulation 1521 to provide guidance to county assessors and taxpayers by explaining the application of the Sales and Use Tax Law to the sale and installation of solar cells, solar panels, and solar modules. Since solar energy technology has advanced, there has been uncertainty within the solar energy industry regarding the application of tax to construction contracts providing for the furnishing and installation of photovoltaic systems.

The guidance the Board provided specifies that photovoltaic cells, solar panels, and solar modules are considered materials when they function in the same manner as other materials such as roofing, windows, or walls and are incorporated into, attached to, or affixed to real property such that they lose their identity by becoming an integral and inseparable part of the real property. However, other types of photovoltaic cells, solar panels, and solar modules are considered fixtures when they are accessory to a building or other structure and do not lose their identity as accessories when installed.



Maintaining parity for registered domestic partners with respect to transfers of property interests to the surviving partner upon the death of the other partner. On January 3, 2008, the California Supreme Court denied a petition by the Sutter County Assessor and others seeking review of a California Court of Appeal decision affirming the Board's authority grant property tax protections to registered domestic partners.

The case of *Michael V. Strong v. State Board of Equalization* began in 2005, when the Board was challenged on the validity of its Property Tax Rule 462.240 relating to property transfers between registered domestic partners upon the death of one of the partners and whether the surviving partner should be subject to a reassessment on the property interest of the deceased partner. The Board prevailed in this case in the trial court, the Court of Appeal, and the California Supreme Court, thus striking down plaintiffs' arguments once and for all that such transfers of property interests are subject to reassessment as a change in ownership.

While this case was being litigated, the Legislature acted to bolster the Board's authority in granting change in ownership property tax exclusions, by enacting Senate Bill 565 (Migden), Chapter 416, Statutes of 2005, that was sponsored by Chairwoman Yee. SB 565 confers property tax exclusions to registered domestic partners that are similar to those enjoyed by married spouses.



Pursuing enhanced efforts to close the gap between the amount of taxes owed and the amount of taxes paid to the state. In anticipation of the state's upcoming fiscal challenges, the Board developed and adopted a series of budget change proposals to address the "tax gap" --- the difference between the amount of tax owed to the state and the amount actually remitted to the state. It is important to note that these measures to close the tax gap are focused on increasing compliance by taxpayers to existing laws and requirements.

The Governor's Proposed 2008-09 State Budget recognizes the importance of maintaining funding for the revenue-generating agencies such as the BOE and the FTB so as not to erode their ability to address the tax gap and assist with addressing the overall State Budget gap between revenues and expenditures. The Proposed Budget includes funding for the BOE as approved by the Board to do the following:

- Expand the Compliance and Outreach Program to identify and register businesses that sell goods without a seller's permit, thereby evading payment of sales and use taxes.
- Implement audit and collection program improvements.
- Concentrate on businesses that purchase goods without paying applicable use taxes.
- Expedite filing of tax liens for out-of-state debtors who file for bankruptcy.



The Governor's Proposed 2008-09 State Budget also includes funding for the FTB to address the state's income tax gap, as follows:

- Focus on registered owners of luxury vehicles who do not file tax returns.
- Identify persons who file federal income tax returns without filing a state return.
- Enhance the collections program.
- Require persons with personal income tax liabilities over \$20,000 to submit their payments electronically.

Enhancing Taxpayer Services

Over the past year, Chairwoman Yee has worked hard to make the BOE accessible to taxpayers and the general public. Key initiatives established under her leadership include the following:

Increasing the transparency of the BOE.



The February 27, 2007 Board meeting was the first to feature a live audio broadcast over the Internet. Chairwoman Yee notes, “Live audio broadcasts allow the Board to reach a broader audience throughout the state and provides greater transparency of this publicly-elected board.” Work is underway to add video to the live broadcasts over the Internet.

Providing free resources and important contacts to taxpayers.

- **East Bay Small Business Fair:** On October 11, 2007, Chairwoman Yee, in co-sponsorship with California State University (CSU) East Bay President Dr. Mo Qayoumi, convened a one-day tax seminar for small businesses in the East Bay region. With over 600 registrants and representatives from the BOE, the FTB, the Employment Development Department, the IRS, the Service Corps of Retired Executives of the Small Business Administration, and other state and federal agencies making presentations and exhibiting information, the day proved to be a success for those interested in either starting a business or growing an existing business.



Chairwoman Yee comments, “The partnership with CSU East Bay is so valuable, with its Small Business Development Center serving those in need of tax information for their business ventures. I look forward to continuing this relationship working with CSU East Bay under the leadership of Dr. Qayoumi.”

- **Basic Sales and Use Tax Classes in Vietnamese and Spanish:** On October 16th and November 14th, Chairwoman Yee sponsored the Basic Sales and Use Tax Class in Vietnamese and Spanish, respectively, in the San Jose District Office. The classes attracted business owners and operators who sell clothing and footwear, perform services on and sell computers and electronics, sell video games, operate a cellular phone kiosk, run a bookstore, sell at flea markets, and operate restaurants.



In observing class attendees over the last year, Chairwoman Yee remarks, “It is so rewarding to see the excitement of these new business owners from our emerging ethnic communities, proud of their business ventures and committed to understanding and complying with their state tax requirements by attending these classes” Many thanks to the excellent instructors in the San Jose District Office: Anna Wu, My-Ly Nguyen, Linh Vu, Vi Nguyen, Vy Dang, Moises Barrera, Lucho Harry, Rosalinda Thomas, and Ruth Arceo.



During 2007, tax information and resources were provided to over 1,200 attendees in the First Equalization District at outreach events like the ones described above.

Bringing the BOE into the 21st century. Over the past year, the BOE has continued its expansion of e-services to taxpayers and feepayers. Current e-services include the following:

- Electronic Funds Transfer (EFT), which allows taxpayers and feepayers to make their payments electronically, thereby eliminating the use of paper checks. EFT payments may be initiated by telephone, computer software, or over the Internet.
- Sales and Use Tax E-filing, which provides eligible taxpayers a more convenient electronic method of filing their tax returns and paying amounts owed.
- The Credit Card Payment Program, which allows taxpayers to make their sales and use tax payments using a VISA, Mastercard, American Express, and Discover Network credit cards.

In 2008, subject to appropriation of funds by the Legislature, the E-services Program will expand to allow on-line filing of returns for some of the BOE's special tax programs. Of the BOE's E-services Program, Chairwoman Yee says, "I appreciate the Legislature's commitment to fund our E-Services program efforts because making filing and payment more convenient for taxpayers surely will ensure compliance."



Building community partnerships to assist taxpayers. Chairwoman Yee was the featured guest on Goldenlink Financial Radio, KVTO 1400 AM in San Francisco on December 19, 2007. Producer Karen Liu and Interviewer Danny Tse coordinated and conducted a one-hour interview translated in Chinese with Chairwoman Yee about the BOE for its primarily business and financial community audience. Topics discussed included the role and responsibilities of the BOE; the application of tax on Internet sales and purchases; how to apply for a seller's permit; how to close out a seller's permit; predecessor and successor liability for sales and use tax; and the anticipated \$14 billion state budget gap.

Chairwoman Yee thanks KVTO 1400 AM for its interest and new partnership with the BOE. She notes, "Being able to discuss practical sales and use tax issues that affect retailers in the San Francisco Bay Area during an evening radio program for an hour is a valuable opportunity to reach out to small businessowners at a time when they are more likely available to receive this information."



Kudos to BOE District Staff

Core to the success of the BOE in accomplishing its mission of serving the public through fair, effective, and efficient tax administration is the dedication of our staff. In complimenting the staff, Chairwoman Yee states, “The continued commitment of the staff to their work is remarkable in light of continuing fiscal pressures that have necessitated our agency to do more with less.”

To express her appreciation for the tremendous work and accomplishments of dedicated women and men in the First Equalization District Offices in Oakland, San Francisco, San Jose, and Santa Rosa, Chairwoman Yee personally visited each of the District Offices before Christmas to thank the staff for their public service on the “front lines” and putting a positive face to the BOE through the assistance they provide to California taxpayers each and every day. She also extended her gratitude to Terri Pahler, Wolfgang Liebelt, Veronica Santillanes, and Suzanne MacInnis, the District Administrators for Oakland, San Francisco, San Jose, and Santa Rosa, respectively, for their continued leadership.



Developing Leadership in the Asian and Pacific Islander American Community

As part of her continued personal commitment to leadership development in the Asian and Pacific Islander American (APIA) community, Chairwoman Yee addressed the diverse group of college students who attended the third annual Asian Pacific Leadership Conference at the University of California, Santa Barbara on November 10-12, 2007. Conference participants discussed an array of topics that included identity politics, civic participation, power dynamics, and coalition building.

“I am honored to have joined State Controller John Chiang, former broadcast journalist Tritia Toyota, civil rights attorney Angela Oh, and APIA community leader Mona Pasquil to encourage these young adults to invest in their communities and public service,” Chairwoman Yee states.

Additionally, on December 4, 2007, Chairwoman Yee administered the oath of office to the Honorable Gilbert Wong, newly elected to the Cupertino City Council in November. She notes, “I am proud of Gilbert’s achievements as a Planning Commissioner for the City of Cupertino and as a parent and community advocate. I know he will bring his experiences to his new office to fight for preserving the quality of life for Cupertino residents.”



Thanksgiving: A Time to Give Back to the Community

Chairwoman Yee joined 6,000 other runners and walkers at HP Pavilion in San Jose on Thanksgiving morning for the third annual Applied Materials Turkey Trot to raise funds for the Second Harvest Food Bank, The Housing Trust of Santa Clara County, and the Children's Health Initiative of the Santa Clara Family Health Foundation.

Participating for the second year, Chairwoman Yee observes, "It is heartening to see the generosity of Silicon Valley residents, devoting their Thanksgiving morning to such worthy causes. A special thanks to Applied Materials and the Silicon Valley Leadership Group for its vision to convene this event every Thanksgiving so we can help those in need in our community."

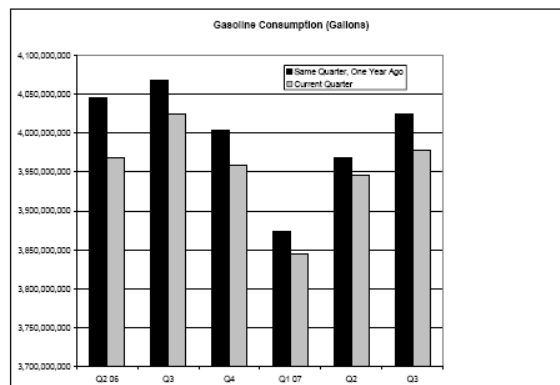
The first year of the Turkey Trot attracted 1,200 participants. In the second year, the number jumped to 3,000. Chairwoman Yee expects the 2008 event to exceed the 6,000 participants last year.



Gas Consumption Watch

In our ongoing gasoline consumption watch, Chairwoman Yee reported at the end of December that Californians used 2.6% less gasoline in September 2007 than they did a year earlier, despite a drop in price.

According to Chairwoman Yee, "Figures for the third quarter of 2007 mark the sixth consecutive three-month period to show a continuing decline in gas consumption, when Californians used 46.2 million gallons less gasoline than they did in the same period a year earlier. This is remarkable, especially in light of the fact that the average pump price of gasoline in the third quarter of 2007 was \$3.02 compared to \$3.14 in the third quarter of 2006."



Challenges That Lie Ahead

Chairwoman Yee notes, “As 2008 begins, several challenges lie ahead for California in the sales and use tax arena, most notably the State’s fiscal condition.”

Bridging the State Budget gap. As California’s state budget gap grows between revenues and expenditures, there will be increased pressure on the BOE and the FTB to be aggressive in collecting the state’s revenues, especially since the Legislature likely will not achieve a two-thirds vote to increase taxes.

Facing a deficit of \$3.3 billion in the current fiscal year and an \$11.2 billion deficit in the 2008-09 fiscal year, the BOE will work diligently to secure funding to close the sales and use tax gap as described above, which is expected to generate \$129 million in the 2008-09, increasing to \$193 million in 2009-10. Should the funding be approved, the BOE will work expeditiously to recruit and hire additional staff primarily in the field to implement the tax gap measures specified above.



With respect to the overall budget shortfall, Chairwoman Yee observes, “Whether one believes the State has a spending problem or a revenue problem, difficult choices must be made to address the budget gap. Sustainable solutions to closing the gap necessarily include raising taxes, for cutting programs merely shifts the demands for services and borrowing our way out of the problem only buys time before another shortfall hits.”

Competing for the State’s workforce. As the “baby boom” generation reaches retirement age and as state compensation levels fall short of those in the competing federal government, local government, and private sectors, the state will continue to face challenges recruiting and hiring for specialized classes of positions, including auditors and information technology specialists. This will pose hardship especially to the BOE as it attempts to attract and maintain qualified personnel to implement its tax gap measures, expand its E-services program, and enhance its technology capabilities.



Allowing medical marijuana dispensaries to continue operations. This year will be a make-or-break year for medical marijuana dispensaries --- many of which are located in the First Equalization District --- if they can survive the tactics employed by the federal Drug Enforcement Agency (DEA) to shut them down, including the recent strategy of pursuing landlords of dispensary tenants and seizing their properties.

In 1996, California voters passed Proposition 215 to exempt patients and caregivers from criminal penalties when they possess or cultivate marijuana for medical use as recommended by a physician. On the heels of voters approving the initiative, the Legislature enacted a regulatory framework that authorizes local governments to work with dispensaries so medical cannabis could be provided to seriously and terminally ill patients in a non-disruptive manner. Eleven other states have similar laws following California’s model.



Since 2005, the DEA has raided dozens of dispensaries and collectives, with 28 of these raids occurring since June 2007 in 11 different counties in California. Los Angeles County saw a record of four raids in a single day last year. Although the U.S. Supreme Court upheld the DEA’s authority to conduct these raids in *Raich v. Ashcroft*, it left state medical marijuana laws intact. Angel Raich of Oakland had sued the federal government in 2002 to prevent it from interfering with her right to use medical cannabis for an inoperable brain tumor, seizures, life-threatening waste syndrome, and severe chronic pain.

The DEA believes these dispensaries are illegal drug dealers facilitating recreational drug use. However, Chairwoman Yee asserts, "Most of the dispensary operators who have contacted the BOE for information about how to obtain seller's permits to collect and remit sales taxes are not fugitives, but responsible persons willing to abide by the laws to conduct their businesses."

The DEA has seized the assets of several dispensaries in the First Equalization District, including bank accounts containing amounts dispensaries have collected in sales tax from their patients. In fact, the timing of some of the raids and asset seizures has caused checks written by dispensaries for remittance of sales tax to the state to bounce. Chairwoman Yee is working to examine how the state can reclaim these seized assets that rightfully belong to the State of California and to fight for continued, regulated operations of these medical marijuana dispensaries.

Preserving independent booksellers and other bricks-and-mortar businesses. With the increasing popularity and acceptance of online shopping, independent booksellers and other Main Street businesses are slowly going out of business, unable to stay competitive with larger, on-line retailers that have no physical presence in California and thus do not collect use tax from their California consumers.

The use tax is a companion tax to the sales tax, which is imposed on the retail purchaser of tangible personal property. In general, the use tax applies to out-of-state purchases of tangible personal property for use, storage, or other consumption in California where the seller was not required to pay California sales tax. The Legislature enacted the use tax in 1935 to ensure that California businesses are not subject to untaxed competition from out-of-state sellers. The use tax rate is the same as the sales tax rate. The rate of use tax is determined by where the property will be used, stored, or consumed (e.g., where the purchaser is located), regardless of where the sale takes place.

Almost all California consumers know that when they buy tangible personal property in a retail store in California, the retailer may collect sales tax reimbursement on the taxable sale from the consumer and the retailer then reports and remits the tax to the State. However, when California consumers purchase tangible personal property online or through mail order from out-of-state retailers who do not collect tax on the purchase or when California consumers bring tangible personal property into California from out-of-state or from a foreign country, they may owe use tax on the purchase and use of the tangible personal property. Ensuring California consumers report and pay use tax is one of the most significant areas of tax non-compliance. Chairwoman Yee will be continuing to work to ease the compliance burden for consumers. Approximately \$1.3 billion in use tax goes unreported and unpaid each year.



Preparing Now to File Your 2007 Income Tax Returns

April 15th --- when income tax returns must be postmarked to the IRS and the FTB --- is just around the corner. Many taxpayers procrastinate preparing their returns, scrambling last-minute to find records needed to complete their returns.

However, returns filed under these conditions are often inaccurate, forcing the taxpayers to either amend their returns later, lose deductions to which they may be entitled, or find out in an audit they owe more tax plus interest.



Chairwoman Yee, also member of the FTB, urges taxpayers, "Start gathering your records now, and prepare your returns early! This is not as difficult as it might seem." As a reminder, she further notes, "State law requires registered domestic partners to file joint income tax returns beginning this year for the 2007 tax year."

Most of your records should be mailed to taxpayers in January. By January 31st, taxpayers should receive the following records that are most, and maybe all, of what they will need to complete their federal 1040 and California 540 tax returns:

- W-2 statements from employers reporting wage income and federal and state tax withheld
- 1099-MISC statements reporting payments to independent contractors
- 1099-INT statements from financial institutions showing interest income
- 1099-DIV statements from financial institutions or companies showing dividend income
- 1099-B statements from brokerage or mutual fund companies showing capital gains and losses as well as the acquisition cost of mutual fund shares or stock shares
- Form 1099-G postcard from the FTB showing the amount of any state tax refund received
- Form 1099-G showing unemployment compensation received
- Form 1099-R statements showing pension and retirement plan distributions and tax withheld
- Form SSA-1099 showing Social Security benefits received
- Form 1099-MISC showing royalties or rents received
- Form 1098 statements showing mortgage interest paid
- K-1 schedules showing partnership and S corporation income



Quickly gather any other records you need. Taxpayers also should start collecting any copies you have of the following:

- Copies of rent checks showing rental property income, and records of expenses and repairs
- Self-employment expenses and any income not reported on a Form 1099
- Divorce or separation papers to substantiate alimony received or paid
- Receipts or acknowledgements for cash and non-cash charitable contributions
- Receipts for medical expenses
- Receipts, cancelled checks, or other substantiation of employee business expenses, investment expenses, professional dues, tax preparation expenses, fees paid for safety deposit boxes, and other miscellaneous deductions
- Social Security numbers for claimed dependents
- Records of estimated tax payments
- Records to substantiate the business use of a home, showing the percentage used as a home office
- Records of casualty losses (insurance claims records) and theft losses (police reports)
- Written acknowledgement of the sales price of any vehicle donated to charity (must be attached to returns). Recent law changes limit the deductible contribution to the sales price collected by the charity selling the donated vehicle.



The California return is based on the federal return. To file a California 540 return, a taxpayer also needs records of interest received on federal government bonds and municipal bonds from other states. California taxable income starts with federal adjusted gross income, with additions for municipal bond interest from states other than California (which the federal government does not tax), and subtractions for federally taxed items California does not tax (interest on federal government obligations, state tax refunds, unemployment compensation, and Social Security payments).



Pay attention to the Use Tax line on the California return. The California personal income tax return provides a line to report the amount of purchases of out-of-state merchandise, particularly over the Internet, where the seller does not collect California sales tax because the seller is located outside of the state. Californians should pay the use tax owed on these items directly to the state on their personal income tax return. Therefore, taxpayers should collect records of major non-taxed online or out-of-state purchases made in 2006.



There is still more time after April 15th. Taxpayers who need an extension should file IRS Form 4868 at this time, and they will automatically have until October 15th to file both their federal and California returns. If a taxpayer files for an extension, any income tax s/he owes must still be paid on or before April 15th with IRS Form 4868 and FTB Form 3519.



Taxpayers should keep their records after filing their returns. Taxpayers should keep copies of tax returns for at least four years, along with substantiation of any credits and deductions claimed and copies of W-2 and similar forms.



They should keep records of the cost basis for mutual funds, stocks, and real property until you dispose of them. The same applies for records of improvements to a home, depreciation schedules, repairs, and rents on investment property.

Taxpayer assistance is available from a number of sources. There are many free resources on the IRS website at www.irs.gov that can assist taxpayers with their filing requirements:

IRS Publication 552, *Recordkeeping for Individuals*

IRS Publication 583, *Starting A Business And Keeping Records*, if you are or may become a business owner

IRS Publication 910, *Guide to Free Tax Services*.

In addition, the IRS and the FTB have Taxpayer Assistance programs where one can obtain in-person help:

- Visit www.irs.gov or look in the phone book under “United States Government, Internal Revenue Service” for a listing of Taxpayer Assistance Centers.
- Visit www.ftb.ca.gov for a listing of approximately 1,800 California locations where trained volunteers provide free help during tax filing season. Taxpayers may also contact the FTB toll-free at 1-800-852-5711 to find a location near them.



Upcoming Events

Upcoming outreach and education events from January 1, 2008 through March 31, 2008, to assist taxpayers are listed below. These events are offered free of charge.

January

22 Spanish Sales and Use Tax Class – Santa Rosa

23 East Bay Income Tax Seminar for Registered Domestic Partners– Oakland

24 State Income Tax Seminar for Registered Domestic Partners – San Francisco

February – No Events Scheduled

March

5 Chinese Sales and Use Tax Class – San Jose

6 Small Business Seminar – East Contra Costa

26 Spanish Sales and Use Tax Class – Oakland